

# Office of City Auditor

## REVIEW OF REHABILITATION AND EMERGENCY ASSISTANCE FOR CITY HOMEOWNERS (REACH) PROGRAM

July 13, 1999

**Project Managers:** Linneth Riley-Hall  
Eileen M. Norton

City Auditor: Susan Cohen  
Deputy City Auditor: David Jones

Auditors: Susan Baugh  
Susan Kraght  
Jerry Stein  
Scottie Veinot

Administrative Staff: Carolyn Yund  
Theresa Velasquez

July 13, 1999

The Honorable Paul Schell  
Seattle City Councilmembers  
City of Seattle  
Seattle, Washington 98104-1876

Dear Mayor Schell and City Councilmembers:

Attached is our report on our review of the Rehabilitation and Emergency Assistance for City Homeowners (REACH) program. We obtained comments from officials in the Office of Housing and when appropriate, we incorporated their comments into this final report.

We appreciate the assistance and professionalism of the Office of Housing personnel with whom we worked to complete this review. If you have questions regarding this report please call me at 233-1093 or Linneth Riley-Hall at 233-0088.

Sincerely,

Susan Cohen  
City Auditor

## **TABLE OF CONTENTS**

<b>BACKGROUND .....</b>	<b>2</b>
<b>SCOPE .....</b>	<b>2</b>
<b>RECONCILIATION OF THE LOAN LEDGER SYSTEM TO THE CITY’S ACCOUNTING SYSTEM.....</b>	<b>3</b>
<b>MASTER FILE MAINTENANCE.....</b>	<b>3</b>
<b>REACH FUND POSITION .....</b>	<b>4</b>
<b>FUND BALANCES .....</b>	<b>5</b>
<b>LOAN PORTFOLIO .....</b>	<b>6</b>
<b>DELINQUENT LOANS.....</b>	<b>7</b>
<b>CITY’S LIEN POSITION .....</b>	<b>7</b>
<b>NUMBER OF LOANS SERVICED .....</b>	<b>8</b>
<b>PROGRAM COST .....</b>	<b>9</b>
<b>MANAGEMENT REPORTS .....</b>	<b>10</b>
 <b>APPENDIX A - REACH Program Fund Position</b>	
<b>APPENDIX B - Office of City Auditor Report Evaluation Form</b>	

---

## **BACKGROUND**

City Ordinance 117472 authorized the Department of Housing and Human Services (DHHS) to establish the Rehabilitation and Emergency Assistance for City Homeowners (REACH) program in January, 1995. The REACH program serves low and moderate income homeowners by providing loan and weatherization services. REACH is a consolidation of four programs, (1) the Emergency Code Repair (ECR), (2) Neighborhood Housing Rehabilitation Program (NHRP), (3) the Seattle Housing Authority's (SHA) loan program for low income home owners, and (4) a multi-source fund weatherization program.

Funding sources available for the REACH low income housing program are: (1) Trust Fund, (2) HOME Investment Partnership Program Funds, (3) Community Development Block Grant (CDBG) and (4) 1995 Housing Levy. In order to create a revolving fund for REACH loans, all program income received or to be received through December 1999 is appropriated for making additional REACH loans.

The goals of the REACH program are to:

- provide decent, safe, sanitary housing and a suitable living environment for lower-income Seattle families;
- eliminate slums, blight, and deterioration of property;
- assist low and moderate income homeowners to maintain and continue to live successfully in their homes;
- increase the energy efficiency of dwellings; and
- preserve the existing housing stock as cost effectively as possible.

---

## **SCOPE**

The purpose of this review was to develop an understanding of REACH's funding by (1) reviewing reconciliation of loan financial records to the accounting system (SFMS) for accuracy and completeness; (2) determining the 12/31/98 fund position; (3) identifying the various funding sources that support the REACH program; (4) reviewing the program's costs; and (5) reviewing the City's security on outstanding loans.

We conducted this audit in accordance with generally accepted government auditing standards.

We have discussed each of the issues contained in this report with Office of Housing management. They agree with all of the issues and recommendations and specified what actions will be taken by their office.

---

## **ISSUES**

---

### **RECONCILIATION OF THE LOAN LEDGER SYSTEM TO THE CITY'S ACCOUNTING SYSTEM**

The Loan Ledger system is not reconciled to the accounting system. Expenditures inputted to an Excel spreadsheet are compared to the accounting system (SFMS); however, there is no ongoing reconciliation of REACH total expenditures and program income on the Loan Ledger system to the City's accounting system (SFMS).

#### **Recommendation**

Ongoing reconciliation of REACH to SFMS should be performed by the Office of Housing to ensure REACH records are properly authorized and accurately recorded in SFMS.

Procedures should be developed by the Office of Housing to require reconciliation of REACH expenditures and program income on the Loan Ledger system to the accounting system.

#### **Action Plan**

Office of Housing will expand the detail level reconciliation report that is currently performed and roll it to the broad management or fund level. This expanded reconciliation report and the written procedures will be in place by Third Quarter 1999 following conversion to Summit.

---

### **MASTER FILE MAINTENANCE**

The CDBG unit instructs Office of Housing finance personnel to perform masterfile maintenance within SFMS. Master file maintenance allows changes to be made to accounting information without leaving an audit trail. When reviewed it appears that

these items are unauthorized, however further research indicates that they appear to be reasonable entries.

## **Recommendation**

Controls should be implemented to ensure that when changes to accounting records are made there is an audit trail. The audit trail should reflect, at a minimum, what changes were made, reason for the change and who made the change.

In general, master file maintenance should not be allowed but, if necessary, there should be a full and complete audit trail maintained.

After full conversion from SFMS to Summit, we recommend that file maintenance be reviewed to ensure an accurate audit trail does exist within Summit.

## **Action Plan**

The Human Services Department (HSD) agrees that an audit trail should be created when using masterfile maintenance. Such a feature was not available in SFMS. HSD was unsuccessful in protecting its electronic records of masterfile maintenance requests to the SFMS administrators, as its only records were destroyed in personal computer upgrades. HSD will not allow this to happen again.

This situation should no longer be an issue, as the new accounting system, SUMMIT, implemented this past week, does not have a feature such as masterfile maintenance. Transactions are documented by journal entry. Should a feature such as the SFMS masterfile maintenance become available in SUMMIT, HSD will ensure that an alternative manual record is maintained that provides an audit trail for the grants and programs administered by the department, including the CDBG Block Grant.

---

## **REACH FUND POSITION**

Based on information obtained from the City's 1994 through 1998 budgets and the accounting system (SFMS), we determined that as of 12/31/98 the fund position of the REACH program was \$8,499,813. (See Appendix A).

While financial information is routinely provided to Office of Housing management (fund study once a year, and financial status reports twice a year) the program does not have frequent, formalized fund position statements.

## Recommendation

The program would benefit from more frequent, formalized fund position statements. These fund position statements should be used by Office of Housing management to make decisions.

### **Action Plan**

Office of Housing has taken steps to ensure these reports are currently in place and has begun to systematically report on GARMs, fund balances, and other management reports.

---

## FUND BALANCES

The total balance of REACH's four funds as of 12/31/98 was \$8,499,813.

Home Fund. As of 12/31/98 the Home fund had \$1,155,443 in available funds. These available funds are from 1993 through 1997 allocations and program income received through 1998. HOME did not receive a budget allocation in 1998. Expenditures for 1998 totaled \$493,600.

CDBG. As of 12/31/98 CDBG had \$2,824,495 in available funds. Its 1998 budget was \$1,423,226. The budget only authorizes the level of spending activity occurring in the CDBG fund, and does not add any actual new dollars to the fund. Expenditures for 1998 totaled \$631,252.

Levy. As of 12/31/98 Levy had a fund balance of \$170,690. Levy receives an annual budget allocation as appropriated by the 1995 Levy. The 1998 Levy budget allocation was \$403,871. Expenditures for 1998 totaled \$522,010.

Trust Fund. As of 12/31/98 the Trust fund had a balance of \$4,349,185. A portion of the interest from the Trust fund serves as income to pay for some of the REACH program's administrative costs. The 1998 budget was \$742,814 and expenditures were \$451,423. Similar to CDBG, the budget only authorizes the level of spending activity occurring in the Trust fund, and does not add any actual new dollars to the fund.

## Recommendation

The City Council should consider deferring further REACH budget allocations in the HOME and Levy funds until allocations from prior years are utilized. Further, Office of

Housing management should be required to provide a detailed explanation of significant variances in each of the four funds between budgeted and actual expenditures.

#### **Action Plan**

Office of Housing has sent an initial request to Council suggesting reprogramming \$3 million of this fund balance, and will report to Council on the use of the remaining fund balance.

---

### **LOAN PORTFOLIO**

As of 12/31/98 there was a total loan balance of \$10.9 million. Of the total (1091) loans serviced, 49% (536) were deferred, 43% (469) were amortized, 6% (63) were 1989 Bonds loans and 2% (23) were loans being worked by the Law Department. Fifty-six percent (\$6,133,866) of the portfolio dollar balance consists of deferred loans. In addition, there is no mechanism currently in place to monitor when the deferred or amortized loans mature.

#### **Recommendation**

A mechanism should be developed to determine when REACH loans mature, i.e., how many and the dollar amount of loans maturing in 5, 10, 15, 20 years, etc. This could be a helpful tool for Office of Housing management to: determine the status of the loan portfolio, estimate cash flow, and analyze the large volume and maturity dates of deferred loans.

#### **Action Plan**

Office of Housing will utilize the existing loan servicing system to create a report generated from the maturity date field which will summarize potential deferred loan payoffs. This report will be part of the reporting mechanism to management discussed earlier in this report and should be a valuable budgeting tool.



---

## **DELINQUENT LOANS**

As of December 31, 1998 there were ten loans that were 90 days or more delinquent, or 2% of the total number of amortized loans. The principal balance of the delinquencies is minimal (\$28,736) compared to the total loan balance for amortized loans of \$3,921,847. Seven of the delinquent loans have been set up with a re-payment plan, six are 2 years delinquent or greater, and one is more than seven years delinquent. Currently there is no report that reflects the status of delinquent loans.

### **Recommendation**

Office of Housing needs to develop a report to show the status of delinquent loans. This report should be used to assist management in making collection decisions. City funds should be collected in a reasonable period to be available for other REACH loans.

### **Action Plan**

The current REACH loan portfolio report that is compiled each month will be expanded to include narrative as to the status of seriously delinquent loans.

---

## **CITY'S LIEN POSITION**

Out of a total population of 274 loans closed in 1996 through 1998 we reviewed 56 (20%) to determine the City's lien position. Of the loans reviewed, the City was in first lien position for 50%, in second lien position for 34%, and in third lien position for 16%.

For 8 of the 56 loans reviewed, the promissory notes referenced a deed of trust filed for a previous loan. According to REACH staff, previous lenders (before the program came to the City) did not re-record a deed of trust for subsequent loans; instead, the lender relied upon the promissory note and the original deed of trust.

### **Recommendation**

Office of Housing should re-evaluate its policies of accepting third lien position and securing loans made by previous lenders.

### **Action Plan**

Office of Housing will use loan to value (LTV) ratios to determine acceptable risk to the City. This is common practice for evaluating collateral position within the home improvement industry.

---

### **NUMBER OF LOANS SERVICED**

There has been a 19% decrease in the number of loans serviced over the past 2 years.

For the 12 month period beginning January 1, 1997 and ending December 31, 1997, there was a decrease of 106 in the number of loans serviced. For the 12 month period beginning January 1, 1998 and ending December 31, 1998, there was a decrease of 115 in the number of loans serviced. For this two year period there was a total decrease of 221 in loans serviced. In addition, for the three month period beginning January 1, 1999, and ending March 31, 1999, there was a decrease of 26 loans serviced.

<b>Year</b>	<b>Number of loans serviced</b>	<b>Decrease in loans serviced</b>	<b>Loan portfolio balance</b>
<b>March 31, 1999</b>	1065	26	\$10,804,804
<b>December 31, 1998</b>	1091	115	\$10,960,305
<b>January 1, 1998</b>	1206		\$11,182,644
<b>December 31, 1997</b>	1206	106	\$11,356,938
<b>January 1, 1997</b>	1312		\$11,633,174

In January 1997 the total loan balance was \$11,633,174 and in December 1998 the total loan balance was \$10,960,305. During this 2 year period the total loan balance decreased by \$672,869 or 6%.

### **Recommendation**

Office of Housing needs to analyze the REACH program to determine why there has been a steady decrease in its loan portfolio, and to also determine whether there is still a need for the program. Also, further allocations to REACH should be deferred until an analysis of the program has been performed and previous allocations from 1993 through 1998 have been spent.

We also recommend that the current program review being conducted by the Office of Housing should:

- (1) compare Seattle's REACH program (including program costs and administrative costs) with similar efforts in other jurisdictions;
- (2) seek to locate models for operating the program;
- (3) determine the demand for the rehabilitation loans in the City and,
- (4) review the program's marketing strategy.

### **Action Plan**

Office of Housing has incorporated these elements within the program review consultant's scope of work. The report should be complete by late July and will be immediately presented to the City Council.

---

### **PROGRAM COST**

REACH closed 82 rehabilitation loans in 1998 totaling \$1,700,000. Other costs for the program were \$983,306. Other costs include, but are not limited to the following: space at four neighborhood service sites, trucks and cars for 12 construction specialists, salaries, office supplies, office space, fleet, and advertising.

REACH weatherization revenue for 1998 from various funding sources totaled \$3,519,285. Total expenditures were \$3,518,762. Contractual expenses were \$2,402,917. Other costs for the weatherization program were \$1,115,845, including inspectors' salaries.

### **Recommendation**

We do not have a recommendation at this time because the REACH program currently has a consultant performing a program review. The Office of Housing is required to report program efficiencies to the Council this fall. The Office of City Auditor plans to revisit the Office of Housing this fall to ensure that the program review and Office of Housing have adequately addressed the program cost issues.

---

## **MANAGEMENT REPORTS**

Office of Housing management is not currently provided with the necessary information to analyze the REACH program's effectiveness.

### **Recommendation**

Indicators of reasonable performance should be defined by REACH management, and necessary performance data provided to Office of Housing management, so that decisions can be based on factual information. Indicators of reasonable performance may include: loans booked each month, deferred loans paid off each month, market conditions affecting the loan program, applications received, applications denied and reasons for denial, applications withdrawn and reasons for withdrawal, program cost, and administrative cost.

### **Action Plan**

Office of Housing has incorporated these elements within the program review consultant's scope of work. The report should be complete by late July and will be immediately presented to the City Council.

In addition, Office of Housing is requiring that a pipeline report be included in its overall program management report.

---

## **SEGREGATION OF DUTIES**

Inadequate segregation of duties and controls exists in certain areas of the REACH program. Functions associated with loan servicing have been absorbed by the Finance Supervisor. The REACH Finance Supervisor performs various tasks which do not provide for adequate segregation of duties. These tasks include: approving loans; approving requests for loan documents; approving the encumbrance; setting the loan up on Loan Ledger and tracking expenditures on an Excel spreadsheet; determining the funding source; requesting disbursements; receiving loan payment information from the bank and inputting this on the Loan Ledger system; receiving some loan payments directly from customers and providing information to sweep the lock box account. The Finance Supervisor also prepares a reconciliation at the transaction level which ensures that Loan Ledger and SFMS reconcile to each other.

On April 1, 1999, the REACH Finance Supervisor re-assigned some of his duties to another employee.

**Recommendation**

Office of Housing needs to ensure there are proper segregation of duties within the REACH program. We recommend that Office of Housing management use the program review to develop and implement controls that ensure adequate segregation of duties.

**Action Plan**

Office of Housing has made some changes, and continues to make changes, to its practices to properly segregate duties and provide controls for loan servicing functions.